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Supreme Court of the State of New York
Appellate Division: First Department

IFINEX INC., BFXNA INC., BFXWW INC., TETHER HOLDINGS LIMITED, TETHER OPERATIONS LIMITED, TETHER LIMITED, TETHER INTERNATIONAL LIMITED,
Respondents-Appellants,

-against-

IN THE MATTER OF THE INQUIRY OF LETITIA JAMES, ATTORNEY GENERAL OF THE STATE OF NEW YORK,
Petitioner-Appellee.

MEMORANDUM OF LAW IN SUPPORT OF RESPONDENT-APPELLANTS' EMERGENCY MOTION FOR A STAY PENDING APPEAL AND FOR AN INTERIM STAY

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INTRODUCTION

This motion seeks a stay pending appeal of a special proceeding in which the trial court granted the Office of the New York Attorney General ("OAG") an Order compelling onerous discovery against the virtual currency exchange "Bitfinex" (collectively, appellants iFinex Inc., BFXNA, Inc., and BFXWW, Inc.) and against an affiliated business, "Tether" (collectively, appellants Tether Operations Limited, Tether Limited, and Tether International Limited; with Bitfinex, the "Companies"), which issues "stablecoins" called tethers. The special proceeding was filed under Gen. Bus. L. § 354, which authorizes OAG to apply to the Supreme Court for discovery and injunctive relief after OAG has "determined" to bring a civil action under the Martin Act, but before actually doing so.

A stay is necessary because otherwise this appeal will likely become moot. **Absent a stay, the Companies will be forced to produce the very discovery that they will be arguing on appeal is unauthorized. Once the discovery is produced, any relief provided by this Court will be effectively meaningless**. The trial court's decision, in refusing a stay pending appeal, failed to address this critical point.

This Court should be especially concerned about maintaining its ability to afford effective appellate relief here because this appeal has substantial merit. Specifically, the trial court lacked both personal and subject matter jurisdiction to

proceed at all, and committed errors in refusing to dismiss the proceeding on these grounds (among others).

With respect to subject matter jurisdiction, the virtual currency targeted by OAG's application—tether—does not qualify as either a security or commodity under the Martin Act. The trial court concluded that the question was close enough to be decided later, if and when OAG actually brings its civil action. But this is backwards. For OAG to bring to bear the full power of the state government against the Companies, the trial court should have made a determination as to whether the product at issue was or was not within OAG's statutory mandate. OAG failed to even attempt an explanation of how tethers could qualify.

The trial court's reliance on OAG's bare assertions that its investigation may at some point touch upon products that *do* qualify as securities or commodities was an error. The question before the trial court pertained to a particular product that was the subject of the § 354 application. Whether the Court might have subject matter jurisdiction over a different application, focused on different products, is a question that was not before the trial court. This error was part of a broader pattern of the trial court focusing on OAG's representations about the scope of its potential investigation—a constantly moving target—instead of the particular transactions upon which OAG's application under Gen. Bus. L. § 354 was premised.

With respect to personal jurisdiction, the trial court concluded that service on counsel was sufficient, overlooking that the Martin Act has a specific service provision mandating personal delivery of a certified copy of the § 354 order to the respondents. Gen. Bus. L. § 355. Here, OAG improperly emailed and hand delivered an uncertified copy *to counsel*. This Court has previously dismissed a § 354 proceeding when OAG tried to mail an order under § 354, *see Abrams v. Lurie*, 176 A.D.2d 474 (1st Dep't 1991), and the result should be the same here.

Apart from the service problem, there is no basis for personal jurisdiction because: (i) the Companies lacked sufficient contacts with New York – they have had no U.S. presence and have barred New York customers from using their platforms for years; and (ii) OAG's claims in support of its § 354 application are unrelated to the Companies' minimal contacts with the forum.

First, ignoring the Companies lack of sufficient New York contacts, the trial court appeared to adopt OAG's bare say-so that it was investigating unspecified wrongdoing dating back to before the ban on U.S. customers, but OAG put forth no evidence of wrongdoing from earlier periods to that effect, despite having already undertaken months of jurisdictional discovery.

Second, in determining whether OAG's claims are related to the Companies' purported contacts with New York, the trial court's analysis should have focused on the transaction at the heart of OAG's application: a loan earlier this year from

Tether to Bitfinex that, according to OAG, impaired the reserves "backing" tether that were to be available to redeem customers' tether for traditional currency. OAG claims that this loan rendered false certain representations that tethers were "backed" by traditional currency. But in assessing personal jurisdiction, the trial court erroneously failed to analyze these allegations and whether they were related to the Companies' alleged contacts with New York, and instead relied on ever-shifting theories of what the OAG says its allegations potentially are (which were not the basis for the § 354 application).

Further, it should be noted that OAG's allegations about the transaction are wrong. The Companies changed their Terms of Service before the loan to make clear that Tether could use its funds to make loans to affiliates. And far from any impairment, Tether has had ample funds to meet its customers' redemption requests—every time, without fail—despite the market disruption that this reckless proceeding has engendered.[1]

A stay would cause no prejudice to OAG, and granting a stay would conserve the judicial resources of the trial court and the Special Referee appointed to oversee the discovery at issue. In fact, the Companies are not seeking a stay of the preliminary injunction, which mandates that they preserve evidence. As

[1] Additionally, as discussed in the Companies' moving brief to the trial court, the Companies maintain custody and control over documents OAG seeks outside the U.S., and the statutory provision at issue, Gen. Bus. L. § 354, does not apply extraterritorially. (Ex. 17 at 16-25.)

discussed, customers have never been harmed in the slightest, and have now had several months to redeem their tethers for full value, if they so desire. Notably, should OAG prevail on this appeal, its investigation will not be hindered.

Accordingly, the Court should immediately stay any discovery proceedings before the trial court and grant an interim stay pending a decision on this motion.

BACKGROUND

Bitfinex and Tether

Bitfinex is among the largest virtual currency trading platforms in the world. (Ex. 2 ¶ 3.)[2] It was founded in 2012, and it is the world's largest exchange by volume for trading Bitcoin against the U.S. Dollar. (*Id*.)

Tether operates a platform to store, send, and make purchases of a digital token known as a tether, and is responsible for issuing tethers. (*Id*. ¶ 4.) Tethers are a form of "stablecoins," which means their value is pegged or tied to traditional currency (U.S. Dollars, Euros, or Japanese Yen). (*Id.* ¶ 6.) Tethers are issued by the company Tether and can, with certain restrictions—*e.g.*, to comport with Tether's anti-money laundering, counter-terrorist financing, and sanctions obligations and policies—be redeemed on a one-to-one basis from Tether for the traditional currency in which they are denominated. (*Id*.)

[2] Citations in the form "Ex. __" refer to the exhibits to the accompanying affirmation of Charles Michael.

Stablecoins such as tethers provide significant utility in the virtual currency market, allowing users to convert cash into digital currency, and to anchor (or tether) the value of digital currency to the price of traditional fiat currencies. (Ex. 2 ¶ 7.) Tethers also provide a medium of exchange across a wide range of trading platforms that is often more convenient than traditional currency. (*Id*. ¶ 8.) Stablecoins are not intended to be used for investment purposes; their main function is to facilitate other virtual currency transactions. (*Id*. ¶ 9.)

The Companies Do Not Transact Business Here

The Companies have decentralized operations in various countries including Hong Kong, Taiwan, and Switzerland. (Ex. 16 ¶ 6.) Neither maintains any office in the United States. (*Id*.)

Bitfinex and Tether do not advertise or market to individuals or entities in New York, or the United States generally. (*Id*. ¶ 16.) Moreover, via its Terms of Service, Bitfinex has barred New York customers from its platform altogether since January 30, 2017, extended that ban to all U.S. Persons in August 2017, and then to U.S. entity customers as of August 2018. (*Id*. ¶¶ 8-10.)

The term U.S. Person is defined broadly to include U.S. citizens, residents, U.S. business entities, or foreign entities controlled by U.S. citizens, residents or U.S. business entities. (*Id*. ¶ 11.) Moreover, the Terms of Service expressly provide that any person that "resides, is located, has a place of business, or

conducts business in the State of New York" is prohibited from being a Bitfinex customer. (*Id.* ¶ 10.)

Tether similarly stopped servicing U.S. Persons (defined the same as above) on November 23, 2017, and thus no longer provides issuances or redemptions of tether to any United States customers. (*Id.* ¶ 12.) In addition, the Tether Terms of Service expressly provide that any person that "resides, is located, has a place of business, or conducts business in the State of New York" is prohibited from being a Tether customer and, accordingly, cannot obtain, purchase tethers from, or redeem tethers from, Tether. (*Id.* ¶ 13.)

Each of the Companies conducts screening to prevent U.S. customers from opening accounts, and if a customer is later determined to be a U.S. person in violation of the Terms of Service, that customer's access to services on the platform through the account is terminated. (*Id.* ¶¶ 11, 14.)

Bitfinex's Banking Relationships and Dealings with Crypto Capital

Virtual currency exchanges and businesses face significant challenges in identifying and maintaining traditional banking relationships, due in large part to banks' concerns about the perceived regulatory and compliance burden of engaging with customers in this nascent industry. (Ex. 2 ¶ 11 & Ex. 3.)

In light of such difficulties, the Companies relied on third-party payment processors as a supplement to, or while seeking, relationships with traditional

financial institutions. (Ex. 2 ¶ 14.) (Broadly speaking, a "payment processor" is a third party that facilitates financial transactions between parties.)

To that end, Bitfinex first established a relationship with a payment processor known as Crypto Capital from at least in or about January 2015. (*Id*. ¶ 15.) Until 2018, Crypto Capital processed hundreds of millions of dollars' worth of transactions on Bitfinex's behalf. (*Id*.)

In or about mid-2018, other virtual currency trading platforms using Crypto Capital began to experience delays in withdrawal requests. (*Id*. ¶ 17.) In or about August 2018, Crypto Capital represented to senior executives of Bitfinex that funds being held by Crypto Capital for Bitfinex had been the subject of a partial governmental seizure directed at Crypto Capital and were expected to be released shortly. (Ex. 2 ¶ 18.) Since this time, at least one governmental entity has confirmed that it was involved in the seizure of Crypto Capital funds. (*Id*.)

Notwithstanding the foregoing, Crypto Capital continued to provide payment-processing services to Bitfinex through approximately October 2018. (*Id.* ¶ 19.)

The Line-of-Credit Transaction

Beginning in or about August 2018, and continuing through in or about November 2018, Bitfinex entered into a series of transactions whereby tethers sold by Tether to Bitfinex were purchased by Bitfinex through transfers from Bitfinex's

account at Crypto Capital to Tether's account at Crypto Capital. (Ex. 2 ¶ 21.) Throughout these transactions, all U.S. Dollar tether issued or redeemed was reserved at an equivalent amount of value in U.S. Dollars. (*Id.*) Additionally, customer requests to purchase, sell, or redeem for cash value U.S. Dollar tether continued unabated. (*Id.*)[3]

At the time, the Companies believed that withdrawals at Crypto Capital would resume, and the Companies would once more have unencumbered access to the funds entrusted to Crypto Capital. (Ex. 2 ¶ 23.) But in or about December 2018, senior executives of Bitfinex grew concerned that Crypto Capital may fail to return funds held there. Accordingly, and for the protection of their customers and the market, the Companies began to negotiate a credit facility through which Tether would extend Bitfinex a secured, revolving line of credit of up to $900 million. (*Id.* ¶ 24.)

In short, the amounts transferred from Bitfinex's Crypto Capital account to Tether's Crypto Capital account were incorporated into the credit facility, so the credit facility obligated Bitfinex to repay those amounts on commercially

[3] During this period, customer redemptions of tether would be initiated directly with Bitfinex, which would purchase redeemed tethers from the customer and then, in turn, redeem tethers with the company Tether. To effect the aforementioned transactions, the Companies engaged in a series of transactions in which Tether remitted funds to Bitfinex via the Companies' respective accounts at Deltec Bank, in exchange for Bitfinex transferring an equivalent amount of fiat currency on deposit with Crypto Capital from Bitfinex's account at Crypto Capital to Tether's account there. (Ex. 2 ¶ 22.)

reasonable terms (*i.e.*, a term of three years and interest rate of 6.5%). (Ex. 2 ¶ 28) The credit facility further provides clear terms governing future requests by Bitfinex to utilize any portion of the remaining line of credit, and provides terms for the repayment. (*Id.*)

Separate and independent counsel were retained for both Companies. (Ex. 2 ¶ 25.) White & Case LLP represented Tether and Herbert Smith Freehills represented Bitfinex. (*Id.*) In addition, final authority to negotiate and approve the transaction on the Tether side was delegated to a Tether executive who was not an officer, employee or shareholder in Bitfinex. (*Id.*) Over the next three months, the credit facility was negotiated and memorialized. (*Id.*)

In February 2019, well before the line-of-credit transaction closed, Tether updated the disclosures on its website to specify that its reserves "may include other assets and receivables from loans made by Tether to third parties, which may include affiliated entities." (Ex. 2 ¶ 31; Ex. 4, at 6 (Item 1.1.32).) The website also made clear that risks in buying tether included risks associated with the reserves: "Assets backing digital assets such as Tether Tokens, including loan receivables owed to Tether, are subject to the risk of default, insolvency, inability to collect, and illiquidity." (Ex. 5, at 2 (Item 7).)

The industry press covered these changes. In March 2019, *Bitcoin Magazine* published an article under the headline, "Tether Updates Website, Says USDT

Backed by 'Reserves,' Not Just Cash." (Ex. 6.) The same day, *Marketwatch* published an article with the headline, "Tether reverses claim of 100% dollar backing, sparking criticism." (Ex. 7.)

For whatever alleged "criticism" the change engendered, however, the markets remained confident in tether, as it continued to trade in the secondary market—*i.e.*, on exchanges other than Bitfinex—at par or better (*i.e.*, at least $1 for every U.S. Dollar Tether, or USDT) after the reporting. (Ex. 2 ¶ 32; Ex. 8, at 2 (showing closing price of tether at $1.00 and $1.01 on March 14 and 15, 2019, respectively).)

The Attorney General's Investigation and
The Companies' Extensive Cooperation

In November 2018, the Companies also learned that the Attorney General was conducting an investigation regarding the Companies, and counsel for the Companies proactively reached out to the Attorney General's office to offer their cooperation. (Ex. 9 ¶ 5.) In the following months, and up until the Attorney General's April 24, 2019 *ex parte* petition, discussed below, the Companies were fully cooperative with OAG's investigation, in part to allow the Companies to educate OAG regarding the Companies' purposeful efforts to avoid contact with New York. (*Id.* ¶¶ 5-48.)

The Companies voluntarily made 12 separate document productions, comprising over 19,000 pages of material. (*Id.*) They further provided 26 pages of

written responses to the Attorney General's information requests (Ex. 9 ¶¶ 43, 47), while voluntarily disclosing to the Attorney General the existence of the contemplated line-of-credit transaction one month before it closed and promptly producing the deal documents immediately after it happened. (*See id*. ¶ 4; Ex. 11, at 3.)

The Attorney General's *Ex Parte* Application

Without any prior warning or notice to the Companies, and notwithstanding weekly contact and cooperation with OAG, on April 24, 2019, OAG filed its *ex parte* petition in this matter under Gen. Bus L. § 354 requesting that the Companies produce huge volumes of information and seeking a preliminary injunction. (Ex. 1.) The focus of the application was the line-of-credit transaction, now claimed to be somehow undisclosed and "conflicted" and which, according to OAG, depleted the "reserves" backing tether. (Ex. 1 ¶¶ 72-93.)

In fact, the transaction was conducted at arm's length and Tether has disclosed since February 2019 (before the transaction closed) that its reserves could be deployed for loans to affiliated entities. (Ex. 2 ¶¶ 25, 31-32.) (And on February 20, 2019, the Companies disclosed the contemplated transaction to OAG. (Ex. 9 ¶ 22.)) OAG further claimed that the Companies have made misrepresentations as to whether tethers are fully backed by equivalent fiat currency, but failed to acknowledge the Companies' prior disclosures on this

matter (or to provide the "who, what, where, when" of the purported misrepresentations).

OAG nonetheless sought a broad injunction prohibiting either company from (among other things) "access[ing]" or making any "claim" on Tether's reserves. (Ex. 10, at 4.) Justice Debra A. James signed OAG's proposed *ex parte* order largely unchanged (the "§ 354 Order"). (*Id.* at 5.) For purposes of OAG's document demands, Justice James referred the matter to Special Referee Steven E. Liebman. (*Id*. at 2.)

OAG emailed the Order—and mailed or sent by hand-delivery—to the Companies' counsel, even though counsel never indicated to OAG that they were authorized to accept service of process for purposes of a § 354 proceeding (or any other court proceeding, for that matter). (Ex. 9 ¶ 49 & Exs. 12, 13.)

In stark contrast to OAG's claim that the line-of-credit transaction presented the risk of irreparable harm through loss of funds, Bitfinex has since made a pre-payment of $100 million to Tether (inclusive of then-accrued interest) well ahead of the schedule set forth under the credit facility. (Ex. 20 ¶ 33.)

The Companies Challenge the Injunction

On April 30, 2019, the third business day after the *ex parte* order, the Companies moved, by Order to Show Cause, to vacate or modify it. (Ex. 14.) In doing so, the Companies made clear that they were not consenting to jurisdiction,

"because, among other reasons, they do not operate in the United States, and because both companies bar New York residents from doing business on their platforms." (*Id.*, at 17 n.1.)

On May 16, 2019, the Court granted the motion, in part, substantially narrowing the preliminary injunction, both in scope and duration. (Ex. 16.) The Court did not address any issues of personal jurisdiction and deemed it premature to address the Companies' subject-matter-jurisdiction challenge that tether was neither a commodity nor security. (*Id*. at 8.)

The document demands remained unchanged. On Friday, May 17, 2019, Special Referee Liebman informed the Companies that if a stay of the order was not issued by 1:00 p.m. on Thursday, May 23, 2019, he would require the Companies to begin promptly producing documents to OAG.

The Companies' Motion to Dismiss and the August 19, 2019 Order

On May 21, 2019, the Companies moved to dismiss the proceedings for lack of personal jurisdiction and subject matter jurisdiction (among other grounds). (Ex. 17.)

The Companies simultaneously sought by order to show cause an interim stay of the § 354 Order, which immediately granted. (Ex. 18.) The trial court halted discovery except to those "topics deemed by the Special Referee to be relevant to whether Respondents are subject to personal jurisdiction in this Court

for purposes of this special proceeding." (Ex. 18, at 2.) Between May and July, the companies produced 70,000 pages of documents—involving 15 custodians across 10 different communication platforms—through seven productions over six weeks, all on the topic of personal jurisdiction. (Ex. 20 ¶ 38.)

On August 19, 2019, the trial court denied the Companies' motion to dismiss. (Ex. 22.)

First, the trial court found that there were "facts sufficient to warrant the exercise of personal jurisdiction" based on what OAG "has represented to the Court" were connections between the Companies and New York, and based on the Companies' contacts with New York and business in New York prior to exiting the U.S. markets. (*Id*. at 11-17.)

Second, the trial court found that email service of the § 354 Order to counsel was sufficient because it provided actual notice of the proceeding to the Companies and because dismissing on that basis "would be a dramatic waste of resources." (*Id*. at 17 n.8.) The Court stated in passing that OAG complied with the service requirements of CPLR 311, but failed to explain how that could be so, since CPLR 311 does not provide for service upon outside counsel.

Third, with respect to subject matter jurisdiction, the trial court concluded that it "cannot and should not reach a definitive conclusion" as to whether tethers are securities or commodities under the Martin Act, because at least in this pre-

action posture, the trial court deemed it sufficient that OAG had "a reasonable basis for [its] position." (*Id.* at 22.)[4]

Finally, the trial court denied the Companies' request for a stay pending appeal, reasoning that burden and expense alone is not sufficient to demonstrate irreparable harm, and that "although this case presents complex legal questions," the trial court did not "believe that is enough to warrant staying this case and further delaying . . . [OAG's] investigation." (*Id*. at 27.) Crucially, the trial court did not address the Companies' argument that, absent a stay, any relief it sought on appeal would likely be rendered moot.

The Companies filed a notice of appeal to this Court the same day. (Ex. 23.) On August 20, 2019, the Companies notified OAG that they would be presenting this emergency application to this Court, and invited OAG to participate. (Ex. 24.)

ARGUMENT

CPLR 5519(c) authorizes this Court to "stay all proceedings to enforce the judgment or order appealed from pending an appeal." CPLR 5519(c). This Court has the discretion to determine whether to grant a stay. *Grisi v. Shainswit*, 119 A.D.2d 418, 421 (1st Dep't 1986). In determining whether to grant a stay, courts

[4] The trial court also found that its orders did not contemplate extraterritorial application of the Martin Act because "OAG's ongoing investigation concerns purportedly fraudulent conduct that has taken place 'within or from New York.'" (Ex. 22 at 25.) This was in error because the § 354 Order would require the production of documents maintained overseas by two companies located outside of the United States. The Companies intend to brief this issue on appeal.

have considered the following factors: (1) whether the appeal has merit; (2) whether any prejudice will result from granting or denying a stay; (3) whether the stay is designed to delay proceedings; and (4) whether the stay will serve the public interest. *See, e.g.*, *Herbert v. City of New York*, 126 A.D.2d 404, 406-07 (1st Dep't 1987); *Russell v. N.Y.C. Hous. Auth*., 160 Misc.2d 237, 239 (Sup. Ct. Bronx Cty. 1992).

As set forth below, each of these factors weighs in favor of a stay here.

I. The Companies Would Suffer Extreme Prejudice without a Stay

Where "absent a stay pending appeal . . . the appeal will be rendered moot," the appellant suffers the "quintessential form of prejudice." *In re Country Squire Assoc. of Carle Place, L.P.*, 203 B.R. 182, 183 (B.A.P. 2d Cir. 1996) (internal citation and quotation marks omitted). That is why a stay in those circumstances is typically appropriate.

In *Van Amburgh v. Curran*, 73 Misc. 2d 1100, 1100 (Sup. Ct. Albany Cty. 1973), the trial court granted a stay pending appeal of a petition to modify a subpoena because, without a stay, the appeal would be "rendered academic." Similarly, in *First City, Texas-Houston, N.A. v. Rafidain Bank*, 131 F. Supp. 2d 540 (S.D.N.Y. 2001), the trial court denied a bank's motion to quash a subpoena, but stayed the case pending appeal of a contempt order. As the court explained, the bank would "suffer irreparable harm unless a stay of the discovery sought by

the . . . [s]ubpoenas is granted, since it will then be obligated . . . to provide the very discovery it argues it has no obligation to produce." *Id*. at 543.

These same considerations are present in this case. Absent an immediate stay, the Companies will be forced to complete the very burdensome discovery that they will be arguing on appeal was ordered without authority. Whatever relief this Court may order will likely be meaningless.

The trial court overlooked this critical point. While the trial court observed that discovery alone does not generally amount to irreparable harm (Ex. 22 at 27), the trial court did not consider that, in this proceeding, the substantive relief OAG is seeking—and that the Companies are resisting—is discovery. In this context, allowing OAG to compel the discovery now is to effectively foreclose meaningful appellate review. That harm cannot be remedied after the fact.

Notably, the discovery at hand is also hugely burdensome. The Companies have already spent well over $500,000 responding to just those portions of the document demands that were carved out from the stay—*i.e.*, those requests that bear on personal jurisdiction. (Ex. 21 at 2.) This is not a document production that simply entails pressing a button and collecting emails from a centralized server. On the contrary, the companies and their personnel use more than 10 different communications platforms—several of which are encrypted and pose substantial collection and review challenges. (*Id*.) As a result, the process of responding to

the carve-out from the stay involved an immensely complex document collection, unprecedented in size, involving over ***60 lawyers***. (*Id*.) The costs of complying with the remaining parts of the § 354 Order's very broad document demands could be orders of magnitude higher.

On the other side of the ledger, OAG would suffer no prejudice with a stay because the Court has entered an injunction to address the allegedly conflicted line-of-credit transaction that was the subject of OAG's application, and because the injunction directs the preservation of the requested documents. (Ex. 10.)

Indeed, OAG has made no allegation that investors are facing imminent harm whatsoever. There continue to be no tether holders—in New York or elsewhere—who have suffered any harm at all, as anyone redeeming from Tether has continued to receive exactly what was promised from the outset: tethers exchanged for dollars on a one-to-one basis. And now, more than three months after OAG's public announcement of this special proceeding, Tether customers taking issue with the line-of-credit transaction, if any, have had ample time to redeem, with the facts widely known, if they wished to do so.

Moreover, OAG is in no way inhibited from using the many other investigative tools it has available, including subpoenas to third parties and witness interviews, to keep moving its investigation forward, as it has been doing actively even while the current stay has been in effect.

If OAG believes it has enough information to decide to file an action, as it represented in its initial § 354 Order application, and wishes to move forward and file such an action without further delay, then it remains free to do so. OAG's evident desire to avoid being inconvenienced is far outweighed by the irreparable harm that the Companies face from having to comply with this § 354 Order, at extraordinary expense, which could be mooted by the substantive appeal.

II. The Companies' Appeal Has Merit

A. The Trial Court Lacked Subject Matter Jurisdiction

The trial court erroneously ruled that it "c[ould not] and should not reach a definitive conclusion" as to whether tethers are securities or commodities, since the question could be answered later in a civil action on a full record. (Ex. 22, at 22.) For now, the trial court concluded that OAG's § 354 Order could be enforced if it was not "utterly irrelevant to any proper inquiry." (*Id*. at 20; 21.)

Contrary to the approach the trial court took here, judges have a duty to determine if a government agency is or is not acting within its statutory mandate before the trial court's authority is deployed to compel businesses to comply with an agency's demands.

For example, in *Gardner v. Lefkowitz*, 97 Misc. 2d 806 (Sup. Ct. N.Y. Cty. 1978), OAG issued a subpoena to a diamond firm as part of a Martin Act investigation. The court held that "**a precondition for the issuance**" of an OAG

subpoena was "subject matter jurisdiction on which the issuance can rest." *Id.*, at 810 (emphasis added). The diamond firm argued that diamond sales were not securities transactions under the Martin Act, but the court disagreed, finding subject matter jurisdiction because (among other reasons) the diamonds were "promoted as an investment and a safeguard against inflation" and were "consistently described" as investments. *Id*. at 814. In other words, the court in *Gardner* undertook the very analysis that the trial court here should have done.

In an analogous context of enforcing agency subpoenas, courts recognize that the "enforcing court [must] assure itself that the subject matter of the investigation is within the statutory jurisdiction of the subpoena-issuing agency." *FEC v. Machinists Non-Partisan Political League*, 655 F.2d 380, 386 (D.C. Cir. 1981). In the *Machinists* case, the Federal Election Commission issued subpoenas to various "draft-Kennedy" organizations trying to get Ted Kennedy to run for President, but the D.C. Circuit concluded that those groups fell outside the definition of a "political committee" that the Federal Election Commission was authorized by statute to regulate. *Id*. at 391-96.

The D.C. Circuit did not decide that the "draft-Kennedy" organizations could be subject to a full-blown investigation first, only to decide later if the statute even reached them. That "shoot-first" approach is what the trial court wrongly adopted here, and where its analysis went awry. The trial court cited no case, and

we are aware of none, in which a court asked to enforce a subpoena or analogous discovery order concluded that it could simply defer to another day the question of whether a government agency was acting within its statutory scope.

The trial court's quoted standard—"utterly irrelevant to any proper inquiry"—has nothing to do with subject matter jurisdiction. The quote comes from a case, *La Belle Creole Int'l., S. A. v. Attorney General*, 10 N.Y.2d 192, 199 (1961), enforcing an OAG subpoena to a distributor that was selling liquor "duty free" by mail to New York customers. The Court of Appeals gave wide discretion to OAG as to what documents could be requested (the "utterly irrelevant" standard), but, unlike here, there was no doubt about the statutory authority to investigate the matter covered by the subpoena. *See id.* at 196-97.

As the Court held, the subpoena target was "subject to regulation under the Alcoholic Beverage Control Law," which required "those who traffic in liquor, whether directly or by mail," to be licensed by the State. *Id*. at 198-99. If in the *La Belle* case, OAG had issued the same subpoena to a company that distributed chocolate milk or baseballs, surely the Court of Appeals would have questioned OAG's statutory authority under the Alcoholic Beverage Control Law.

The trial court's reliance on *Anheuser-Busch, Inc. v. Abrams*, 71 N.Y.2d 327 (1988) (Ex. 22, at 20-21), is also misplaced. There, the Court of Appeals upheld OAG's subpoenas to beer companies as part of an antitrust investigation under the

Donnelly Act. The beer companies argued that their alleged misconduct—establishing exclusive distribution territories—was clearly legal, but the Court of Appeals disagreed, finding that those arrangements might be illegal "if shown to result in an unreasonable restraint of trade." *Id.* at 333. In the language the trial court seized upon, the Court of Appeals found that, since the legality was not "free from doubt," OAG should be permitted to investigate further, to see what the evidence showed. Here, by contrast, the question at hand is whether the product at issue (tether) is even covered by the Martin Act in the first place. The Companies are not trying to prove in advance as to what the evidence would or would not show on the merits; they are simply pointing out that tether, since it is not a security or commodity, is not within the statutory reach of OAG. This is quite different from *Anheuser-Busch*, where there was no dispute that the Donnelly Act applied to the beer business.

Accordingly, the Companies intend to show on appeal that no subject matter jurisdiction exists because the subject of OAG's investigation—tether—simply does not qualify as a security or commodity under the Martin Act.

First, tether is not a security because it does not satisfy the definition articulated by the Supreme Court, and adopted by New York courts: tethers do not involve (i) an investment of money; (ii) in a common enterprise; and (iii) with profits to come substantially from the efforts of a third party promotor. *People v.*

First Meridian Planning Corp., 201 A.D.2d 145, 151 (3d Dep't 1994) (citing *SEC v. W.J. Howey Co*., 328 U.S. 293 (1946)). Instead, tethers are a form of "stablecoin" used to facilitate transactions in other virtual currencies, and thus, their purchase or sale does not involve any expectation of profit. Notably, courts have found that comparable instruments, which function as a medium of exchange between markets, do not meet the definition of a security under the *Howey* test. *See, e.g.*, *Lehman Bros. Commercial Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co*., 179 F. Supp. 2d 159, 164 (S.D.N.Y. 2001) (finding that foreign currency exchange transactions and interest swaps do not meet the definition of a security because the value is based on market forces rather than the issuer's entrepreneurial efforts).

Second, tether is not a commodity, which is defined in the Martin Act as "any agricultural, grain, animal, chemical, metal or mineral product or byproduct, any gem or gemstone (whether characterized as precious, semi-precious or otherwise), any fuel (whether liquid, gaseous or otherwise), any foreign currency, and any other good, article, or material." Gen. Bus. L. § 359-e(14)(a)(i). Tether is not, for example, an "animal" or "metal," or even any type of "material," and unlike every other asset, good, or article deemed a commodity by the legislature, stablecoins are not expected to fluctuate in price. *Id*. at § 359-e. Indeed, the closest description applied to tether is a "foreign currency," but the qualifier

"foreign" indicates a currency issued by a foreign sovereign government. Clearly the Legislature did not have in mind privately-issued, virtual "currencies" when the Martin Act was adopted in 1921.

In opposing the Companies' motion to dismiss, OAG offered *no response* to these points, replying instead with the argument that the trial court ultimately adopted—that the inquiry was premature. (Compare Ex. 19, at 15-17 with Ex. 22, at 17-24.) As discussed, that argument is wrong, and this Court should reject it.

Further, the trial court hypothesized that tether "could" qualify as a good (albeit an "intangible" one) (Ex. 22 at 21-22), but goods are commonly understood as "tangible personal property." *See Goods and Chattels,* Black's Law Dictionary (11th ed. 2019); *see also* UCC § 2-105(1) ("'Goods' means all things . . . which are movable at the time of identification to the contract . . . ."). Goods are listed in the definition of commodities alongside other tangibles ("articles," and "material") that under the principle of *ejusdem generis* would indicate that the definition refers to tangible goods. Gen. Bus. L. § 359-e(14)(a)(i). Similarly, the trial court theorized that tether "could" be a foreign currency, but the term "foreign" implies currencies issued by foreign governments. Certainly the legislature's use of the term "foreign" in 1921 was not intended to encompass privately-issued tethers.

Indeed, federal authorities consistently recognize that virtual currencies are not foreign currencies.[5]

More fundamentally, the trial court's animating rationale was that these matters should be fleshed out in discovery, without offering any explanation of how discovery will bear out these points at all. It will not. OAG's subpoena is not aimed at any of these points. The trial court thus should have answered the question of whether OAG was or was not acting within its statutory authority *before* imposing onerous discovery.

Finally, as a fallback, the trial court observed that OAG's investigation may ultimately encompass other virtual currencies that, unlike tethers, "have consistently been treated as commodities (such as bitcoin and ether)." (Ex. 22, at 24.) But OAG's § 354 application, and the resulting § 354 Order, were not about bitcoin or other virtual currencies—they concerned tether only. OAG obtained injunctive relief based on a particular set of allegations centered on tether. Since a § 354 application is supposed to be made only after OAG has "determined" to

[5] *See In re Coinflip, Inc.*, CFTC Docket No. 15-29, 2015 WL 5535736, at *2 n.2 (Sept. 27, 2015) ("Bitcoin and other virtual currencies are distinct from 'real' currencies, which are the coin and paper money of the United States or another country that are designated as legal tender, circulate, and are customarily used and accepted as a medium of exchange in the country of issuance."); *Virtual Currency Guidance*, I.R.S. Notice 2014-21, at *2 (Apr. 14, 2014) ("[V]irtual currency is not treated as currency that could generate foreign currency gain or loss for U.S. federal tax purposes . . . ."); *In re FinCen's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, FIN-2013-G001, at *5 (Mar. 18, 2013) ("Virtual currency does not meet the criteria to be considered 'currency' under the BSA, because it is not legal tender.").

bring a full-blown civil action, Gen. Bus. L. § 354, OAG should have mentioned other products if they were really at issue. Regardless, if OAG wants to investigate wrongdoing relating to other products, it should initiate another § 354 proceeding. It cannot possibly justify this proceeding based on hypothetical speculation about matters that *could* be under consideration.

B. The Trial Court Lacked Personal Jurisdiction

1. Service was Defective

OAG failed to comply with the Martin Act's requirement that § 354 orders "be served upon the person named in the endorsement aforesaid by delivering to and leaving with him a certified copy thereof . . . ." Gen. Bus. L. § 355.

This Court's decision in *Abrams v. Lurie*, 176 A.D.2d 474 (1st Dep't 1991) is controlling. There, the Court recognized that "[t]he words 'delivering' and 'leaving' connote a clear legislative intent that service of a GBL § 354 order be made in accordance with CPLR 308(1), and therefore vacated an *ex parte* § 354 order allowing service to an out-of-state resident and in-state business by registered mail and overnight express mail, given that no reasonable construction of CPLR 308 would permit service by mailing. *Id.* at 475.

The trial court concluded that *Abrams* was distinguishable because it addressed CPLR 308 (concerning service on natural persons), not service on business entities. But the basic thrust of *Abrams* is that the statutory language

about "delivering" and "leaving" under Gen. Bus. L. § 355 is not satisfied by mail—a conclusion equally applicable to the attempt to serve in this case.

To be sure, the CPLR has a separate provision for personal service on individuals (CPLR 308) as compared to corporations (CPLR 311). The trial court seized on that distinction to conclude that it should look to CPLR 311 here. But that does not change the result because OAG's attempt at service did not remotely satisfy CPLR 311. As is relevant here, CPLR 311 refers to "delivering" process to a corporation's "managing or general agent," CPLR 311(a)(1). Service on an outside law firm (by email, email, or otherwise) simply does not count. *E.g.*, *Pinto v. House*, 79 A.D.2d 361, 364 (1st Dep't 1981) (CPLR 311 service on law firm defective absent proof firm was authorized to accept service).

CPLR 311 also allows for trial courts to devise alternate methods of service but only if the traditional methods are found to be "impracticable" after a "motion without notice" is filed. CPLR 311(b). Under this provision, alternatives like e-mail can be available if "the plaintiff is having serious difficulty making service under the existing statutory methods." CPLR 311(b), Practice Commentaries § C311:3 (2013). Nothing like that happened here. OAG made no effort to show any difficulty with the ordinary methods. Without such a showing of impracticability by OAG, the "court is without power to direct expedient service."

David v. Total Identity Corp., 50 A.D.3d 1484, 1485 (4th Dep't 2008) (internal citation and quotation marks omitted).

Even apart from this problem, the trial court failed to even address how OAG satisfied the requirement of serving an order that was certified.[6] OAG did not, and that is an independent basis to conclude there was no jurisdiction.

Finally, the trial court's assertion that the Companies had notice of the proceeding and therefore dismissal "would be a dramatic waste of resources" (Ex. 22, at 17 n.8), misses the point. There is no exception to the service rules where the trial court finds compliance to be bothersome or not useful. To the contrary, "[i]n a challenge to service of process, the fact that a defendant has received prompt notice of the action is of no moment," because "[n]otice received by means other than those authorized by statute does not bring a defendant within the jurisdiction of the court." *Macchia v. Russo*, 67 N.Y.2d 592, 595 (1986).

No statute authorized the service method OAG attempted here, and so the trial court never obtained jurisdiction over the Companies.

[6] There is a special procedure for the Clerk to issue certified copies of orders. *See Certified Copies, NYCourts.gov,* https://www.nycourts.gov/courts/1jd/supctmanh/Certified_Copies.shtml. OAG did not even attempt to do this.

2. OAG's Claims Do Not Arise from Conduct Purposefully Directed Towards New York

Contrary to the trial court's ruling, there is no basis for specific personal jurisdiction because the Companies prohibited U.S. persons from using their platforms well before the relevant allegations. (Ex. 16 ¶¶ 8-12; Ex. 20 ¶¶ 17-19.) (There is no dispute that the Court lacks general jurisdiction over the Companies (Ex. 22 at 9 n.5.).) In concluding that there were grounds for specific personal jurisdiction, the trial court made a number of legal errors.

First, the trial court stated that OAG "has represented to the Court" that there were various connections between the Companies and New York, seeming to rely only on the bare allegations of OAG, instead of the evidence. (Ex. 22, at 13.) This was improper, especially given that OAG has already benefitted from significant jurisdictional discovery.

Second, the grab bag of miscellaneous contacts the trial court cited are insufficient. While the trial court claimed there were New York customers using the platforms after the ban, each example involves overseas customers that qualify as Eligible Contract Participants (ECPs). (Ex. 20 ¶¶ 4; 9-13.) Certain ECPs have had shareholders or other personnel in New York, but the trial court cannot pierce the corporate veil and pretend that those individuals are the Companies' customers. They are not; the customer in each instance is the foreign ECP. *Duravest, Inc. v.*

Viscardi, A.G., 581 F. Supp. 2d 628, 635 n.6 (S.D.N.Y. 2008) (refusing to use the residence of corporate officers as grounds for jurisdiction over the corporation).

More generally, even if the Companies' ban is imperfect, that would not justify asserting jurisdiction, since the key inquiry here is "conduct **purposefully** directed" at the forum state. *J. McIntyre Machinery, Ltd. v. Nicastro*, 564 U.S. 873, 877 (2011) (no jurisdiction where manufacturer "knows or reasonably should know that its products" would end up in forum, absent purposeful conduct towards forum) (emphasis added). The Companies' policy here is purposeful **avoidance**, the opposite of what gives rise to personal jurisdiction.

Third, the trial court considered to be relevant New York contacts on virtually any subject, including the Companies' "business operations, relationships, customers, tax filings, and more," and then speculated that OAG's "eventual civil suit will likely draw on" these matters. (Ex. 22, at 14-15.) But this entirely collapses the distinction between general and specific personal jurisdiction.

For specific personal jurisdiction, there must be a nexus "between the forum and the underlying controversy." *Bristol-Myers Squibb Co. v. Superior Court*, 137 S. Ct. 1773, 1781 (2017). "When there is no such connection, specific jurisdiction is lacking **regardless of the extent of a defendant's unconnected activities in the State**." *Id*. (emphasis added). Here, the underlying controversy is the claim that, under Gen. Bus. L. § 354, OAG has already "determined" to bring—namely

the claim that the Companies misrepresented what was "backing" tethers. That was the focus of OAG's § 354 application. *Cf. Gucci America, Inc. v. Weixing Li*, 768 F.3d 122, 141 (2d Cir. 2014) (specific jurisdiction for purposes of nonparty subpoena should focus on "the connection between the nonparty's contacts with the forum and the discovery order at issue"). If OAG can instead claim jurisdiction based on an infinitely malleable "investigation," then the concept of specific personal jurisdiction is rendered meaningless.

Finally, the trial court cited language from *La Belle Creole Int'l., S. A. v. Attorney General,* 10 N.Y.2d 192 (1961), that personal jurisdiction for purposes of an investigative subpoena can rest on a showing "less than necessary to justify maintenance of a civil suit." (Ex. 22, at 9 (citing *La Belle,* 10 N.Y.2d at 193).) But *La Belle* is no longer good law. The Court in *La Belle* was applying the "doing business" test for determining jurisdiction, but the Supreme Court's decision in *Daimler AG v. Bauman*, 134 S. Ct. 746 (2014) "significantly impacted the 'doing business' test," and greatly limited the scope of permissible jurisdiction. 2 Weinstein, Korn & Miller, New York Civil Practice: CPLR ¶ 301.00 (2016). The trial court forthrightly acknowledged that there was a lack of authority applying *La Belle* "in light of developments in due process assessments of jurisdiction in the intervening years." (Ex. 22 at 11.)

In any case, the facts of *La Belle* are readily distinguishable. There, a Panamanian liquor company took liquor "orders in systematic and continuing fashion through an agent with an established and permanent place of business in this State," without complying with the statutory requirement to be registered. 10 N.Y.2d at 198. In other words, the target of the subpoena there engaged in precisely the sort of purposeful activity in New York, connected to the alleged wrongdoing OAG was investigating, that is missing in this case. There was no basis for specific jurisdiction here.

* * *

In sum, as the Companies will demonstrate on appeal: (i) the trial court lacked subject matter jurisdiction because the cryptocurrency that is the focus of OAG's investigation is neither a commodity nor a security, as required for jurisdiction under the Martin Act; (ii) the trial court lacked personal jurisdiction because service was defective; and (iii) the trial court lacked personal jurisdiction because OAG failed to show that the Companies engaged in purposeful activity toward New York connected to focus of OAG's § 354 application.[7]

[7] Additionally, as noted above, it was an improper extraterritorial application of the Martin Act for the trial court to order the production of documents maintained overseas by two companies located overseas. (*See* Ex. 17 at 16-25.)

III. A Stay of the Trial Court's Ruling Is Not Designed to Delay and Serves the Public Interest

The Companies' request for a stay is not in any way designed to delay. The Companies are pursuing an appeal of the trial court's August 19, 2019 ruling in order to protect their rights and raise substantial, meritorious, and novel legal issues. Further, as the trial court failed to even consider in its analysis, the relief the Companies are seeking risks being completely mooted if they are required to comply with these burdensome and costly document demands even as their meritorious appeal is being considered. If this Court later grants the Companies' motion, thereby removing the obligation to produce any documents to OAG, there will be no way to undo the harm caused by the production of documents prior to the date of this Court's ruling. Moreover, the Companies' good-faith cooperation and production of documents prior to OAG's filing of the § 354 application further highlight how the Companies have not in any way sought to delay OAG's investigation.

A stay will serve the public interest by conserving judicial resources. OAG's document requests under the § 354 Order are broad and voluminous and will require the close guidance of the Special Referee—and very likely the trial court—to effectively tailor the production of documents in response to the requests. A stay will also serve the interests of justice, as basic fairness dictates that the Companies, who have been haled into this forum against their will and

have already incurred extraordinary expense to comply with portions of the § 354 Order to date, should not be made to suffer irreparable harm from being required to comply with that order while seeking relief therefrom. A stay would preserve the status quo for the Companies—at no risk to the OAG's investigation—while these significant and novel legal issues are fully and fairly considered and resolved.

CONCLUSION

For all of these reasons, the Companies respectfully request that the Court stay all proceedings until this Court resolves the Companies' appeal and grant an interim stay pending a decision on this motion.

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